No. 11467

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

SEATTLE BREWING & MALTING CO., a corporation,
Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING

JONES & BRONSON,
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THE ARGUS PRESS, SEATTLE

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TABLE OF AUTHORITIES

STATUTES

TEXTBOOKS

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PETITION FOR REHEARING

TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND TO THE HONORABLE JUSTICE AND JUDGES OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, severally and individually, to-wit:

Hon. William O. Douglas
Hon. Francis A. Garrecht
Hon. William Denman
Hon. Clifton Mathews
Hon. Albert Lee Stephens
Hon. William Healy
Hon. Homer T. Bone
Hon. William E. Orr

The petitioner asks for a rehearing of this case. The petitioner submits as the basis for this request

for a rehearing that this Court was mistaken in viewing the holding and decision of the Tax Court upon the matter under review in this case as involving a mixed question of fact and law; and further, that in view of the total absence of argument or discussion of this point either in the briefs or at the hearing, it should in all fairness be granted opportunity for presentation of its views before the case is disposed of on such a basis.

We think it will help in consideration of this petition, particularly by those members who did not participate in the hearing, to have the following summary of the issues involved and proceedings taken.

On April 23, 1935, Rainier Brewing Company (hereinafter called "Rainier") entered into a contract with petitioner (Ex. 1, Tr. 139) whereby it sold petitioner certain tangible property and granted petitioner a license to use certain trade names, limited as to territory and scope, upon payment of annual royalties related to volume, with the provision that after operating for five years on such a basis petitioner should have the right to convert future royalty payments from the quantity of production to a lump-sum basis, which it did in 1940. Payments made prior to 1940 were claimed and allowed as deductible expense in determining net income for tax purposes. Petitioner thereafter continued to claim similar deductions of amounts substantiated by good accounting practice, as rental for the use of property belonging to another, until the exhaustion of the lump-sum payments, under §23(a)(1)(A), I.R.C.

The Commissioner held that the change in payment converted the transaction into the acquisition of a capital asset and assessed a deficiency resulting from disallowance of the claimed deductions in 1940 and 1941. The Tax Court sustained the Commissioner (Tr. 36), holding that as a matter of law and construction of the contract, the exercise of the option or election by petitioner effectuated a sale of the trademarks under the terms of the contract. It disregarded and did not pass upon petitioner's claim to a deduction on the basis that no sale or transfer of ownership of the trademarks had occurred.

During the course of this proceeding there was also pending a controversy between the Commissioner and Rainier, which had reported the lump-sum payments as gain on the sale of a capital asset, involving a lower rate of tax. The Commissioner disallowed this claim on the basis that the payments made by petitioner to Rainier constitute ordinary rental income. Rainier in its turn petitioned the Tax Court for a review of this holding.

Petitioner's case came on first in the Tax Court and was heard by Judge Mellott, who shortly afterwards resigned before handing down a decision. Rainier's case was tried some months later before Judge Harron, who also took over the *Seattle* case on the record made before Judge Mellott. The *Seattle* case was decided first and later, in deciding the *Rainier* case, which involved other substantial issues, the Tax Court held that Rainier correctly treated the payments as proceeds from the sale of the trade-

marks and applied the rule of capital gains on the basis of its holding in the *Seattle* case. *Commissioner v. Rainier Brewing Company*, 7 T.C. 162.

In its petition to this Court petitioner makes two contentions: first, that the exercise of its option to make lump-sum payments did not result in a sale or acquisition of title or ownership of the trademarks, and secondly, that being true, petitioner is entitled to a deduction to be determined in accordance with good accounting practice of amounts paid for continued use of the trademarks. Petitioner devoted most of its opening brief to the question of whether or not there was a sale, which was the only issue dealt with by the Tax Court. The Commissioner in answering conceded that the Tax Court was in error in deciding that there was a sale, and agreed that there was no sale or transfer of title to the tradenames to petitioner and that its lump-sum payments were in the nature of royalties. He did not, however, agree that such payments were deductible as rent or royalty.

In the *Rainier* case the Commissioner had petitioned this Court for review, Docket No. 11547, and contended in his opening brief much more definitely than he had admitted in his answering brief in the *Seattle* case that the transaction was not a sale. Various other issues were involved and considered on the briefs, including the application of the *Dobson* rule (*Dobson v. Commissioner*. 320 U.S. 489, 88 L. ed. 248) to that case. The two cases were assigned for hearing and heard upon the same day, but they were not consolidated either for hearing or decision, and

the record in this case is wholly and completely independent of the record in the *Rainier* case.

The per curiam opinion in this case, filed January 9, 1948, reads as follows:

> "This, as the companion case of *Commissioner of Internal Revenue v. Rainier Brewing Company*, No. 11547, this day decided, presented to the Tax Court 'hybrid questions of mixed law and fact (and) their resolution because of the fact element involved will * * * afford little concrete guidance to future cases.' We hence do not consider the petitioner's contention that 'the facts found fall short of meeting statutory requirements.' *Bingham v. Commissioner*, 325 U.S. 365, 370; *Choate v. Commissioner*, 324 U. S. 1.
>
> "The decision of the Tax Court is affirmed."

The opinion in the *Rainier* case filed at the same time is identical except for cross reference.

The last sentence of the opinion referring to "petitioner's contention that 'the facts found fall short of meeting statutory requirements'," is wholly irrelevant to this case. It appears to be a paraphrase of a portion of the opinion in the *Bingham* case which was discussing "questions of reasonableness and proximity." Even if justified as to the *Rainier* case, it is wholly inapplicable to this case, in which neither party has raised any contention as to sufficiency of the facts.

While it is true that the *Rainier* case involved a voluminous record of oral testimony and exhibits, and it is possible that the Tax Court's decision in that case might properly be regarded as involving con-

sideration of facts as well as of law sufficient to invoke application of the *Dobson* rule, and so relieve this Court from an examination or review thereof, such a situation does not extend or apply in any respect to this case. There was no evidence whatsoever in this case, either oral or written, other than the contract of April 23, 1935, and its modifications, which tended in the slightest degree, or at all, to establish that the parties had any purpose or intent to sell or transfer the title to the trademarks as distinguished from the licensing the use thereof. The Tax Court made no finding as to the intent or purpose of the parties (Tr. 38-53). It based its decision solely on a consideration of the provisions of the contract (Tr. 40-48).

It is true that there was some evidence offered by petitioners to the effect that Rainier would not make a sale of the tradenames (Tr. 96, 116, 119). This testimony was undisputed and could only be considered as establishing that there was no sale, or be ignored, as it was by the Tax Court in deciding that there was a sale. It could in no sense be considered as furnishing factual support, as distinguished from legal construction, for the Tax Court's determination that there was a sale.

The syllabus or headnote of the Tax Court's opinion (Tr. 36), while not a part thereof, was prepared by the Tax Court and states that "By the exercise of the option under the terms of the contract the taxpayer acquired a capital asset, and the transaction was a sale and not a license." In the body of the

opinion the references and discussion are such as to show that the Court was dealing solely with the legal effect of the contract, and leave no room for doubt that the conclusion and holding was entirely one of construction upon a point of local or general property law. As said by the Supreme Court in *Commissioner v. Henninger*, 320 U.S. 467, 88 L. ed. 121, "the Board of Tax Appeals have denied the claimed deduction not by an independent exercise of judgment but upon a mistaken conviction that denial was required as a matter of law."

The respondent has made no contention or suggestion that the decision of the Tax Court in this case involved any determination upon disputed facts foreclosing a review, and to the best of our recollection, there was no discussion of the *Dobson* rule upon the argument in this case beyond the statement by government counsel that he did not consider it applicable. (We are referring only to the argument in the instant case. There was extended discussion of the application of the *Dobson* rule in the *Rainier* case).

Perhaps if the facts justified it, the objection would be of such a jurisdictional character that it might be raised in spite of the agreement of counsel to the contrary. The position of the Government, however, is not only significant upon the substantive question, but even more important as a matter of fair procedure, it should be taken into account, because under the circumstances petitioner naturally did not include in its brief any discussion or citations bearing

upon the right of this Court to review the issue, which is the basis upon which the decision of the Tax Court is now affirmed.

The petitioner submits, therefore, that from a procedural standpoint it should be entitled to an opportunity to present to this Court its argument and authorities to the effect that the matter in controversy is properly subject to consideration and review as a matter of law. It submits further that from a substantive standpoint, as maintained by both the petitioner and the respondent, the issue decided by the Tax Court of whether or not there was a sale, was based solely on construction of the wording of the contract and is, therefore, subject to review by this Court.

It would not be appropriate here to undertake a detailed discussion of the many decisions bearing upon the right of review in cases of this kind, an extensive analysis and review of which, and of the legislative background and theory of the subject, may be found in Paul's "Federal Estate and Gift Taxation," 1946 Supplement, at pages 526 to 605. If the Court is not already familiar with this text, we urge its consideration in connection with this petition, and particularly call attention to the author's conclusion at page 602 that "the Tax Court's special competence and its informed judgment do not manifest themselves in the determination of local law, which thereupon settles tax consequences."

For recent instances justifying review, see:

Jones v. Commissioner, 152 F.(2d) 392 (C.C.A.-9);

Three States Lumber Co. v. Commissioner, 158 F.(2d) 61 (C.C.A.-7);

Sunderland v. Commissioner, 151 F.(2d) 675 (C.C.A.-3);

Welsbach Engineering & Management Corp. v. Commissioner, 140 F.(2d) 584 (C.C.A.-3);

Lum v. Commissioner, 147 F.(2d) 356 (C.C.A.-3);

Thornley v. Commissioner, 147 F.(2d) 416 (C.C.A.-3);

Helvering v. Stornfeltz, 142 F.(2d) 982 (C.C.A.-8).

We would also expect upon rehearing to discuss the application of the Administrative Procedure Act (5 U.S.C.A. §1001) to a review of the decision of the Tax Court. The Circuit Court of Appeals for the Sixth Circuit has in two cases expressed the opinion that "review of Tax Court decisions is governed by the Administrative Procedure Act." *Lincoln Electric Company v. Commissioner*, 162 F.(2d) 379 at 382; *Dawson v. Commissioner*, 163 F.(2d) 664 at 667. The point was urged but not passed upon in *Credit Bureau of Greater New York v. Commissioner*, 162 F.(2d) 7 (C.C.A.-2) and *Anderson v. Commissioner*, recently decided by the Seventh Circuit and reported in 485 C.C.H. Par. 9109, although in the latter case the Court expresed disagreement with the conclusion reached in the *Lincoln Electric* case. It was raised again in the Sixth Circuit in *Elizabeth G. MacDonald v. Commissioner*, but not passed on, the decision of the Tax Court being held to be supported by substantial evidence. 485 C.C.H. Par. 9110.

While this Court has not referred to the *Dobson* case in its opinion, the doctrine of that case was discussed at length between Court and counsel in the argument of the *Rainier* case, and the two citations given in this Court's opinion are applications of that doctrine. Both of them, however, are clearly distinguishable from the instant case. In *Choate v. Commissioner*, 324 U.S. 1, 89 L. ed. 653, "the Tax Court found that the parties *intended* a cash sale of equipment" (Our italics). In view of that finding it was held that the question was not open to re-dererermination. There is no such finding here, either directly or inferentially, and, therefore, that case cannot be applicable.

In *Bingham's Trust v. Commissioner*, 325 U.S. 365, 89 L. ed. 1670, the other case cited in support of affirmance, the Supreme Court very clearly recognized that decisions of the Tax Court based on legal construction of documents are subject to review. It said in that case:

> " * * * The questions whether, on the facts found, the expenses in question are nondeductible, either because they were not to produce income or because they were related to the management of property which was not held for the production of income, turn in this case on the meaning of the words of §23(a)(2), "property held for the production of income." They are therefore questions of law, decision of which is unembarrassed by any disputed question of fact or any necessity to drawn an inference of fact from the basic findings. See *Commissioner of Internal Revenue v. Scottish American Invest. Co.*, 323 U.S. 119, *ante*, 113,

65 S. Ct. 169, *supra*. They are 'clear cut' questions of law, decision of which by the Tax Court does not foreclose their decision by appellate courts, as in other cases, *Dobson v. Commissioner of Internal Revenue*, *supra* (320 U.S. 492, 493, 88 L. ed. 251, 252, 64 S. Ct. 239), although their decision by the Tax Court is entitled to great weight. *Dobson v. Commissioner of Internal Revenue*, *supra* (320 U.S. 501, 502, 88 L. ed. 256, 257, 64 S. Ct. 239), and cases cited; cf. *Medo Photo Supply Corp. v. National Labor Relations Bd.*, 321 U.S. 678, 681, 682, 88 L. ed. 1007, 1009, 1010, 64 S. Ct. 830), note 1, and cases cited.

"Since our decision in the *Dobson case*, we have frequently re-examined, as matters of law, determinations by the Tax Court of the meaning of the words of a statute as applied to facts found by that court. A question of law is not any the less such because the Tax Court's decision of it is right rather than wrong. Whether or not its decision is 'in accordance with law' is a question which the statute, Internal Revenue Code, §1141(c)(1), 26 U.S.C.A. 1940 ed. §1141 (c)(1), 6 F.C.A. Title 26, §1141(c)(1), expressly makes subject to appellate review. Congress, when it thus authorized review of questions of law only, was not unaware of the difficulties of such a review of the decisions of a tribunal, which decides questions both of law and of fact. But Congress did not dispense with such review.

"Hence the statute does not leave the Tax Court as the final arbiter of the issue whether its own decisions of questions of law are right or wrong. That can only be ascertained upon

> resort to the prescribed appellate process by a consideration of the merits of the point of law involved, and by its decision at the conclusion of the process, not before it begins."

We have confined our discussion on this petition to a consideration of the first point sought to be reviewed of whether or not there was a sale resulting from the exercise of the option. Neither the Tax Court nor this Court has given consideration to the second point of whether, if there were no sale or transfer of title, the lump sum payments or any part thereof are deductible as rental paid for the use of another's property under §23(a)(1)(A) I.R.C. We assume, therefore, that the opinion in this case rests squarely on the first point and is not to be understood as holding that even if there were not a sale, the statute would not support a deduction. But if such ruling is within the scope of the decision, we submit it also involves simply a question of law upon which the petitioner is entitled to the decision of this Court. Such a matter falls squarely within the class of questions stated to be reviewable in the *Bingham* case.

The thought is irresistible, as stated in that case, that "if review were to be denied in this case it would be difficult to say that any construction of a taxing statute by the Tax Court would be subject to appellate review."

For the foregoing reasons we urge that the per curiam opinion be set aside and a rehearing granted herein.

Respectfully submitted,

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